(2)

For Immediate Release

IMPERIAL OIL LIMITED,
111 ST. CLAIR AVENUE WEST,
TORONTO. M5W 1K3

CANADA AND ITS ENERGY:

OPPORTUNITIES WAITING TO HAPPEN

ADDRESS BY

ARDEN R. HAYNES,

CHAIRMAN AND CHIEF EXECUTIVE OFFICER,

IMPERIAL OIL LIMITED

TO

THE EMPIRE CLUB OF CANADA

TORONTO, ONTARIO

JANUARY 26, 1989

(CHECK AGAINST DELIVERY)

Mr. President, head table guests, ladies and gentlemen...

I understand Max Ward was unable to find a buyer for his company until he was invited to speak to the Empire Club. I've also been told that your invitation to me was what tipped the scales in Imperial's favor during our recent negotiations with Texaco. So I guess it's now clear that if you want to conclude a major business deal in Canada, first you have to get yourself on the Empire Club agenda!

To be serious for a moment, I'm sure some of you would like me to talk at length about our acquisition of Texaco. However, as the proposal remains subject to government approval, it's not appropriate to say very much at this time. We're only over the first hurdle, so to speak, and I'd prefer to wait until the full course has been completed before commenting in detail.

I would like to say, however, that at Imperial we're delighted to have been the successful bidder, and we'll be working very hard to conclude the deal to the satisfaction of <u>all</u> interested parties. It will continue to be the goal of employees and sales associates in both organizations to provide Texaco and Imperial customers with the high-quality products and services they have been used to in the past. And our commitment at Imperial extends to the employees of both organizations. In one important respect this is a merger that is different from most... We have undertaken that not a single employee of either Texaco Canada or Imperial Oil will be laid off as a result of this merger.

Now, having said that, let me move on... I believe it was Walter Cronkite who once said it's natural to have butterflies when you speak in public -- the trick is to get them to fly in formation. It usually takes me a few minutes to get my butterflies organized in this fashion, so I hope you'll bear with me.

I'm very honored to have been invited to address the Empire Club. I also appreciate the opportunity to talk about the crude oil and natural gas industry in both a worldwide and a domestic context. It's an important subject, and also a large one, so let me tell you what I'm hoping to achieve today.

Broadly speaking, I hope to raise your comfort level -- meaning that of all Canadians -- with regard to Canada's oil and gas supply security. Both in terms of present and future supply and in terms of the development of our domestic reserves, with all the economic benefits that flow from major development projects, Canada's future looks extremely bright.

This view is derived from a couple of assumptions about the future -- recognizing, of course, that the future has a mind of its own and there's no sure way of predicting its disposition or personality. And recognizing, too, that he who lives by the crystal ball often ends up walking on broken glass.

The first assumption is that, barring some unexpected political or military event causing a physical disruption, available supplies will reach the marketplace. Prices may be higher than today, but supplies will not be withheld. A second assumption is that energy prices will rise but, for reasons I'll get into, at a moderate rate rather than in any series of severe price shocks. And the third assumption is that as prices rise, Canada's abundant oil and gas resources -- which for the most part require somewhat higher prices than those that have prevailed in recent years -- will be permitted by public policy to be developed as they become economic. As and when that happens, as a nation we will begin to reap the full value of our enviable resource base, further enhancing our long-term economic prosperity.

That, in a nutshell, is my message to you today. I also hope, along the way, to put to rest some of the misconceptions that seem to abound in energy-related discussions in this country. Frankly, I can think of few issues on which so much misinformation is handed out to the public -- sometimes innocently as a result of lack of knowledge, but at other times, I believe, by self-serving opportunists with political or ideological axes to grind. As Churchill might have said: "Never have so many been misled by so few."

The problem, of course, is that energy issues are extremely complex. Trying to understand the energy scene, as George Bernard Shaw once said in another context, is like trying to read an airmail letter in a high wind. And trying to <u>explain</u> energy issues is even harder. They simply don't lend themselves to the kind of ten-second explanations many people seem to want, especially on the six o'clock news.

Any time I hear someone try to sum up the energy scene in a "sound bite", I'm reminded of what Woody Allen said after he'd taken a speed-reading course and finished War and Peace in ten minutes. When someone asked him what it was about, he replied: "It's about Russia."

Yet it's the very complexity of energy issues that helps those with an axe to grind to mislead people. They take a single issue or some aspect of it, reduce the complexity to a kind of simplified, bedrock logic, and make a convincing case without regard for the facts.

Today, then, I hope to lay out some of the "real facts" about the world and Canadian energy situation -- focussing, for obvious reasons and also because of time limitations, on oil and natural gas. I'll talk about crude oil first, because the natural gas situation is quite different.

In considering the global crude-oil situation, the most critical fact to bear in mind is that since about 1980 the western world -- meaning specifically the non-OPEC oil-producing countries excluding communist-bloc producers -- has not been replacing its reserves of conventional crude oil. While there is currently a significant "overhang" of non-OPEC oil-production capacity, it is a situation that probably won't be sustained for much longer.

Oil is a non-renewable resource. To turn a popular phrase upside down: when you use it, you lose it. And since 1980, non-OPEC countries have produced and consumed more oil than they've discovered. This is in spite of the fact that free-world demand for oil declined steeply after the sudden price rises in 1979 and is only now returning to 1980 levels.

Most of the major non-OPEC producing regions have passed their peaks of productivity, which is reached at the halfway point of an oilfield's so-called "reserve life". That applies to the major conventional fields in Canada and the United States, including the Alaskan North Slope. It also applies to the United Kingdom's North Sea fields, although not to Norway's.

Of course new discoveries are being made and some new fields brought into production. But really huge discoveries -- of a scale that could affect world supply-demand balances -- are not being made outside of the Middle East.

As a result, barring unexpected major new discoveries, total non-OPEC conventional production will likely not increase significantly, and will almost certainly decline over the longer term. At the same time, free-world demand for oil is expected to increase with general economic growth and especially growth in the developing countries.

The outlook, therefore, is for the gap between world oil supply and demand to narrow, and come into close balance within the next decade.

The importance of this perspective is that it helps focus on who does have the reserves of low-cost conventional oil. And the answer to that, of course, is OPEC. In all likelihood, additional supplies will be in the hands of the major OPEC producers, primarily in the Middle East. As a result, over time OPEC will increasingly regain the ability to control prices by managing production from its members.

In recent years, faced with an overhang of supply and strong competition from non-member producers, it's been difficult for OPEC members to agree on production quotas, or to make any agreement stick for very long. In fact, at times the words "OPEC agreement" have seemed like a contradiction in terms -- like "military intelligence" or, as someone remarked the other day, "Maple Leafs hockey".

Those days are passing. As production from its competitors fails to keep pace with rising demand, the pressure on OPEC and its member countries should ease. OPEC will once again "have the hammer," as we would say in curling. The world price of crude oil should stabilize, and then rise.

That does not mean, I don't think, that OPEC will start wielding that hammer as a blunt instrument, hitting its customers over the head with sudden and dramatic price increases such as we have seen in the past.

It was precisely the 1979 price shock that created the conditions that OPEC has been trying to cope with in recent years. The world responded by sharply decreasing demand for oil through intensified conservation and substitution. At the same time, non-OPEC countries stepped-up their exploration programs and moved to develop their higher-priced reserves.

OPEC is unlikely to give such impetus to the competition again. There is, after all, still lots of oil in the world -- including a lot in Canada -- just waiting for higher prices to spur development. So future price increases are likely to be measured, moderate and more responsive to market conditions.

How high will the price rise, and by what time? Well, Canada's National Energy Board projects that, given strong world economic growth, the price could reach $US 30 a barrel, in 1987 dollars, by the year 2000. That's only eleven years away! In their lower-growth case the price reaches $US 20 a barrel, again in 1987 dollars, shortly after the turn of the century. At Imperial Oil we're a little more bullish than the NEB.

This prospect of a rising oil price has major implications for Canada, but I'll get to them in a moment. First let me talk about the global situation in natural gas which is, as I said earlier, quite different from the crude oil situation.

There is a significant surplus of natural gas in the western world. Most of it, however, is located a long way from the markets that need it -- often with an ocean in between. And unlike crude oil, natural gas is not easily transported over long distances or across oceans. It can be compressed and liquefied for transportation, but this greatly increases the cost. So liquefied natural gas must take its place in the hierarchy of potential energy sources, waiting for a price environment in which it can be competitive.

It's obvious, therefore, that those who can produce natural gas close to the major markets, or at least transportable to them by pipeline, enjoy a significant advantage over those who can't.

That, too, has major implications for Canada -- so let's turn now to the Canadian and North American scene.

The United States currently imports about 40 percent of its total oil requirement. Demand is growing quite strongly -- last year it increased by about 2 percent. As I mentioned earlier, production of US conventional oil, including Alaskan reserves, is in decline. So the US is faced with becoming increasingly dependent on crude oil imports.

The US natural gas situation is a little more complex. For some years now, domestic supply has exceeded demand, resulting in the so-called "US gas bubble." That bubble now appears to be shrinking, and the US will likely become increasingly dependent on Canada and Mexico for supplies. US imports of Canadian natural gas actually increased by about 30 percent in 1988, and may grow by another 10 percent in 1989.

Canada, of course, is extraordinarily blessed in the energy sphere. In this respect as in many others, we're the envy of most other nations.

Our country is a vast storehouse of energy resources -- crude oil, natural gas, coal, uranium, and water. We lead the world in many energy-related technologies, especially oil-sands recovery and both nuclear and hydro-electric power generation. And we have a solid core of people capable of designing, building and managing world-scale energy projects.

We are also, at the present time, net exporters of all forms of energy. I say a net exporter because in some cases imports to one region -- for example, crude oil to eastern Canada and coal to Ontario -- are outweighed by exports from another.

On the crude oil side, while production of conventional oil from western Canada is generally flat to declining, new areas are coming into play or at least waiting in the wings -- such as the Hibernia field off the East Coast, and the Beaufort Sea/Mackenzie Delta region of the western Arctic.

Our real crude-oil ace in the hole, however, is the oil sands. I'm sure few Canadians realize just how big our oil-sands deposits are. They underlie nearly 50,000 square kilometres of territory -- an area larger than the province of New Brunswick. With more than a trillion and a half barrels of oil in place, they constitute one of the three truly enormous deposits of crude oil in the world -- the others being in the Middle East and in Venezuela, also in the form of oil sands.

Even if one assumes that only 10 percent of this oil will be recoverable, that would still be a huge addition to our reserves. Even <u>one</u> percent is considerably more than all of the conventional oil remaining in Canada.

The problem is that the oil sands, as well as our frontier reserves of conventional oil, are and will be very expensive to develop and produce. For example, the average cost of producing a barrel of light crude in, say, Saudi Arabia, is less than $US 5. The cost of producing a barrel of light synthetic crude at Syncrude is around $US 15. Conventional oil from our frontiers will also require prices somewhat higher than the current level to be economic.

The future, however, is on Canada's side. As I've pointed out, the expectation is for prices to rise over the next decade. And as the price rises, our higher-priced oil will become increasingly more economic to produce. We're also fortunate that our frontier oil and even the oil sands do not require prices as high as the oil-shale occurring in South America and the United States, or oil that may be derived from coal.

Now, some people have argued that Canada should develop its higher-priced oil prematurely, through government subsidies, in the name of security of supply. I have argued that this would be particularly inappropriate, given the long-term potential and the likely evolution of world supply, demand and price.

In my view, security of supply is not the issue. Oil is in plentiful supply in the world -- at higher prices, mind you, but even so, barring some physical disruption it's difficult to imagine any nation not having access to available supplies.

What is important is for Canada to develop its resources in an orderly fashion, on a project by project basis just as soon as the economics fall into place. In this way we can realize the full value of the resources. And we can also ensure that the wealth creation that comes from energy development, in terms of jobs and the stimulation of industrial activity throughout our economy, benefits all Canadians.

I'll return to this point in a moment, but first let me comment briefly on natural gas -- another jewel in Canada's energy crown.

Current reserves of natural gas in western Canada -- where there is also potential for significant new gas discoveries -- will satisfy both Canadian and a growing portion of US demand for years to come. As a matter of fact, Canada's gas exports to some parts of the US today are limited only by pipeline capacity, and projects are underway to increase that capacity by about 25 percent within two years, with further increases planned.

Add to this the potential for significant new gas production from the frontiers, and you have a very encouraging outlook, indeed, for Canada's natural gas industry. It's a case of having abundant supplies coupled with direct access to the biggest and hungriest market in the world.

Now, from what I've said so far, let me try to make what is perhaps the most important point of my remarks to you today -- one that many people in Canada don't understand, and that some people who should understand it choose to ignore.

This is that energy resources, especially crude oil, are <u>international</u> commodities. While oil is found in many parts of the world, it is easily transportable and actively traded everywhere. It is the world's most heavily traded commodity, and accounts for a large proportion of total international trade.

It is also internationally <u>priced</u>. This means that every barrel of crude, depending on its quality and after adjusting for transportation costs, has at any point in time the same value as every other barrel of oil, no matter where it's produced.

For this reason, attempts to set national energy policies that try to isolate one country's crude oil from world market forces -- usually by trying to dictate a domestic oil price higher or lower than the world price -- are doomed to failure. There is always a price to be paid, an economic cost to be borne relative to the rest of the world.

An artificially low price prevents domestic producers, as well as producing regions, governments, and the country as a whole, from realizing the true value of the resource. It also discourages the investment needed to discover new reserves or undertake major development projects. An artificially high price similarly penalizes your own economy. It simply makes no sense to produce any commodity at a higher price than you can buy it for.

For these reasons, it's tremendously important for Canada that future governments continue the present public policy stance of viewing Canada's energy in a world-market context.

For a few years in the recent past, Canada's national energy policies were formulated in pursuit of non-energy-related objectives -- some of them purely political objectives -- in the mistaken belief that Canada energy resources, and its oil industry in particular, could be isolated from the world. These policies wrought severe damage on the industry and, indeed, on Canada's economy.

That the present federal government has effectively reversed this policy approach is considerably to its credit. My strongest hope is that future federal governments, along with those of the producing provinces, will not turn the tables over again.

If Canada's high-cost energy resources are to be developed -- with all the wealth-creation that implies -- we must have stable energy policies that are responsive to international market forces, along with a fiscal regime that will keep Canadian producers internationally competitive. Only in such a policy environment can we hope to compete in world capital markets for the levels of investment we will need.

And in this respect, the recent adoption of the Free Trade Agreement with the United States was a significant step in the right direction. I believe it will, in the long run, considerably enhance Canada's energy security.

At the very least, the agreement promotes greater confidence between buyers and sellers in both countries that long-term trading relationships will not be disrupted. And since we are the sellers and they the buyers, the agreement provides Canada with more secure access to markets and customers for our exportable energy resources.

This, in turn, should reduce the risks of proceeding with major energy development projects in Canada. Anything that increases investor confidence in the viability of such projects must work to the benefit of the industry and the country.

Now of course, that is not the view that some people have of free trade. Opponents of the agreement have raised a variety of energy-related concerns, but the two most frequently raised are: One, Canada has surrendered its sovereign ability to establish its own energy policies... and Two, the agreement threatens Canada's energy security by guaranteeing to supply oil, in the event of a general supply disruption, to the US at the expense of Canadians.

These arguments have no basis in fact. First, governments in Canada fully retain their existing powers to create energy policy, including incentives for regional development or even for individual projects. Nor does the agreement alter the distribution of powers between the federal and provincial governments with regard to natural resource ownership or management.

The argument that free trade imperils Canada's energy security in the event of a supply shortage ignores the fact that Canada is a signatory to the International Energy Agreement. This agreement, entered into by the government of Canada in 1974, requires both us and the US to share oil production with other signatories in the event of a major disruption.

That is not to say the International Energy Agreement is a perfect arrangement. It may not be. But the wisdom of being party to some form of international oil-sharing agreement is very clear.

As was demonstrated during the 1979 Iranian oil crisis, no nation can husband its oil supplies while friends and allies run short. Our economies are simply too closely linked, and in too many ways. An event that dramatically impacts the economies of our trading partners must reverberate through our own economy. Only through a sharing arrangement such as this agreement provides can we safeguard our collective security in a supply crisis.

However, even if you overlook the International Energy Agreement, there is nothing in the free trade agreement to prevent our governments from managing supplies of oil or gas for any purpose, including conservation, the creation of a strategic reserve, or to deal with any emergency disruption.

What the agreement specifies is that if the government <u>does</u> restrict supplies, existing US customers must be given the opportunity to purchase -- at prices freely negotiated between buyers and sellers -- the same proportion of the oil and gas that they have purchased, on average, over the preceding three years.

This means nothing more than that customers who have entered into contracts with us in good faith will be treated fairly. They will be given the opportunity to rearrange their sources of supply if and when our government decides to restrict production.

Overall, as I said earlier, I believe free trade will, on balance, benefit Canada's energy industries and enhance our long-term energy security. It will strengthen market relationships. It will encourage exploration as well as investment in major development projects. And it will give a strong boost to energy-related industries such as the Canadian petrochemical industry, which should benefit substantially from free access to US markets. In short I believe it's the right course for Canada, and I believe it's a course worth staying.

Let me summarize and conclude these remarks, then, by sounding a few optimistic notes.

Canada's very abundant energy resources are "wealth in the bank" for our nation and our people. Whether we can realize the dream of every Toronto homeowner and convert our potential wealth into real wealth -- the kind you can buy stuff with -- depends on two things.

The first necessary factor is a world crude oil price that rises to the point where development of our higher-priced reserves becomes economic. While higher energy prices impact on every consuming country equally, any country that also produces energy gains a tremendous economic advantage -- both from the selling of energy to other consuming countries, and from the wealth generated by its development.

The second necessity is a favorable and stable public policy and fiscal environment for the industry. One in which we can assemble the capital, marshall the technology and retain the people to complete development projects that will be among the most challenging ever undertaken anywhere in the world.

Right now, I believe the chances of those two conditions falling into place are very good. Canada's energy ducks -- if not my own butterflies -- are beginning to fly in formation.

Thank you very much.